United States Bankruptcy Court
Northern District of Illinois
Eastern Division

Transmittal Sheet for Opinions

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Bankruptcy Caption: Elite Marketing Enterprises, Inc.

Bankruptcy No.: 99 B 29921

Adversary Caption: Fisher v. American National Bank & Trust Company of Chicago

Adversary No.: 01 A 00418

Date of Issuance: **December 13, 2001**

Judge: **Carol A. Doyle**

Appearance of Counsel:

Attorney for Movant or Plaintiff: Frances Gecker, Freeborn & Peters

Attorney for Respondent or Defendant: Mark Page, Bank One

Trustee or Other Attorneys:

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	Chapter 7
	)	
ELITE MARKETING ENTERPRISES, INC.,	)	99 B 29921
	)	
Debtor.	)	Honorable Carol A. Doyle
	)	
	)	
LAWRENCE FISHER, not individually, but as Trustee for ELITE MARKETING ENTERPRISES, INC.,	)	
	)	
Plaintiff,	)	No. 01 A 00418
	)	
v.	)	
	)	
AMERICAN NATIONAL BANK AND TRUST COMPANY OF CHICAGO,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION AND ORDER

This matter comes before the court on Defendant American National Bank and Trust Company of Chicago's ("ANB") Motion to Dismiss Adversary Complaint pursuant to Federal Rules of Civil Procedure 12(b)(1) and 12(b)(6). On March 1, 2001, Plaintiff Lawrence Fisher ("trustee"), the chapter 7 trustee of debtor Elite Marketing Enterprises, Inc. ("debtor") filed an adversary complaint ("complaint") pursuant to 11 U.S.C. §§ 510, 544, 547(b), 548(a)(1) and 550, and 740 ILCS 160/5(a)(1). The complaint alleges that the transfer of funds from Cole Taylor Bank ("Cole Taylor") to ANB was a preference and fraudulent conveyance. The complaint also alleges that ANB induced a breach of fiduciary duty and was unjustly enriched. Plaintiff seeks recovery of the transferred funds and the equitable subordination of any claim ANB may have against the debtor's estate.

ANB filed a Motion to Dismiss Adversary Complaint ("motion"). The motion seeks dismissal of the trustee's claims of inducement to breach fiduciary duty and unjust enrichment based on lack of subject matter jurisdiction. Under Rule 12(b)(1) of the Federal Rules of Civil Procedure (incorporated into the Federal Rules of Bankruptcy Procedure by Bankruptcy Rule 7012), ANB asserts that the trustee does not have standing to bring these claims. It also seeks dismissal of all claims for failure to state a claim upon which relief can be granted under Rule 12(b)(6) of the Federal Rules of Civil Procedure. For the reasons stated below, the court concludes that the trustee has sufficiently plead each of the six causes of action in the complaint. The motion to dismiss is therefore denied.

Standard on Motion to Dismiss

When considering a motion to dismiss, the court "must accept as true all the factual allegations in the complaint," Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit, 507 U.S. 163, 164 (1993), and must construe the pleadings in the light most favorable to the plaintiff. See Pickrel v. City of Springfield, 45 F.3d 1115, 1118 (7th Cir. 1995); Sidney S. Arst Co. v. Pipefitters Welfare Educ. Fund, 25 F.3d 417, 420 (7th Cir. 1994). A motion to dismiss for failure to state a claim should be granted "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the plaintiffs' allegations." Appley v. West, 832 F.2d 1021, 1030 (7th Cir. 1987) (citing Morgan v. Bank of Waukegan, 804 F.2d 970, 973 (7th Cir. 1986)).

Allegations of the Complaint

The trustee alleges as follows: In August 1995, ANB entered into a banking relationship with the debtor. After ANB learned of possible fraud from a state court action in June 1998 involving the debtor and one of the debtor's former officers, ANB conducted a field examination of the debtor's records in January 1999. As a result of ANB's findings, in February 1999, ANB asked the debtor to "leave" ANB, secure alternative financing, and repay the more than $2.8 million owed ANB. To facilitate the debtor's search for alternative financing, ANB modified its loan agreement with the debtor to create the appearance of compliance with the terms of the existing loans. James Monti ("Monti"), the debtor's former president and majority shareholder, negotiated a loan agreement with Cole Taylor, whereby Cole Taylor agreed to extend to the debtor $5 million in credit, purportedly secured by the debtor's accounts receivable and inventory.

Monti has admitted that in order to obtain the financing, he provided Cole Taylor with false information, including false accounts receivable reports. ANB was aware of the negotiations and the terms of the new financing between the debtor and Cole Taylor, and knew or should have known of the debtor's inability to repay in light of the false reports. ANB never informed Cole Taylor of its concerns. On July 9, 1999, the debtor, Monti and Cole Taylor executed the financing agreement ("agreement"). On the same day, pursuant to the agreement, the debtor wire-transferred $2,832,974.00 to ANB to repay the debtor's outstanding loans from ANB (the "transfer"). On September 27, 1999, after discovering the debtor's true situation, Cole Taylor filed an involuntary chapter 7 petition against the debtor. Cole Taylor has filed a proof of claim against the debtor's estate in the amount of $3,173,117.35.

Count I - § 547(b) Preference Action

The trustee alleges in Count I of the complaint that the transfer of funds to ANB pursuant to the agreement between Cole Taylor and the debtor constitutes a preference under 11 U.S.C. § 547(b). ANB seeks to dismiss the claim on the basis that the debtor lacked an interest in the property transferred, relying on the earmarking doctrine. The earmarking doctrine is a defense to a preference action that applies when a new lender makes a loan specifically for the purpose of paying a particular creditor. Two elements must be established: (1) that the debtor lacked control over the funds at issue, and (2) that the transaction did not result in a diminution of the debtor's estate. In re Smith, 966 F.2d 1527, 1531, 1535-36 (7th Cir. 1992).

Contrary to the trustee's assertion, the earmarking doctrine is not confined in this circuit to cases in which the third party is a co-debtor. In Smith, the Seventh Circuit applied the doctrine without restricting it to cases involving a co-debtor guaranty. See also Steinberg v. NCNB Nat'l Bank of N.C. (In re Grabill), 135 B.R. 101, 108 (Bankr. N.D. Ill. 1991) (Squires, J.). The doctrine is applicable where a third party lends money to a debtor "for the specific purpose of paying a selected creditor." Smith, 966 F.2d at 1533.

The trustee also asserts that the earmarking defense cannot be relied upon because the contract between the debtor and Cole Taylor was induced by fraud and is therefore invalid. However, as the court noted in Smith, the fact that the borrowed funds were obtained by fraud does not affect the analysis - the court must still determine whether the debtor controlled the disposition of the funds. Id. at 1534. Therefore, any alleged fraud in the inducement of the contract between the debtor and Cole Taylor does not preclude assertion of the earmarking doctrine.

Nevertheless, the court cannot determine based on the allegations of the complaint alone whether the debtor lacked any control over the funds or whether the estate was diminished by the transaction. Therefore, ANB's motion to dismiss Count I is denied.

Counts II and III - Fraudulent Conveyance

In Counts II and III, the trustee alleges that the transfer of funds to ANB constitutes a fraudulent conveyance pursuant to § 548(a)(1) of the Bankruptcy Code, 11 U.S.C. § 548(a)(1), and the Uniform Fraudulent Transfer Act ("UFTA"), 740 ILCS 160/5(a)(1), made applicable under 11 U.S.C. § 544(b)(1). ANB asserts that: (1) the debtor lacked an interest in the property transferred; (2) fraudulent transfer law does not apply to an alleged preference; (3) the trustee has failed to plead fraud with particularity pursuant to Federal Rule of Civil Procedure 9(b); and (4) the transfer of funds to ANB could not have been made with an actual intent to defraud creditors on the part of the debtor.

ANB's first argument, that the debtor lacked an interest in the funds, fails for the same reasons stated above with respect to the preference claim in Count I. ANB's second argument, that fraudulent transfer law does not apply to an alleged preference, does not provide a basis for granting a motion to dismiss. A complainant is not limited to only one theory of recovery if the elements of both causes of action have been plead. See, e.g., In re Roco Corp., 701 F.2d 978, 985 (1st Cir. 1983); In re Aluminum Mills Corp., 132 B.R. 869, 892-93 (Bankr. N.D. Ill. 1991) (Schmetterer, J.). Here, the trustee has plead each of the elements of a fraudulent transfer claim and these counts therefore should not be dismissed on this basis.[1]

ANB's third argument, that the trustee has failed to plead fraud with particularity, also fails. When a plaintiff alleges circumstances constituting fraud, Rule 9(b) requires that the facts supporting the motion be stated with particularity. Fed. R. Civ. P. 9(b); see also Volpert v. Volpert (In re Volpert), No. 93 A 01705, 1994 WL 605894, at *7 (Bankr. N.D. Ill. Oct. 26, 1994) (Schmetterer, J.). Knowledge and intent, on the other hand, need only be averred generally. Fed. R. Civ. P. 9(b); see also Baltimore Spice Co. v. B.J. Packing, Inc. (In re B.J. Packing, Inc.), Nos. 91-3075 & 90-33607, 1991 WL 335436, at *3 (Bankr. N.D. Ohio Dec. 5, 1991). Because proof of intent can be difficult to obtain, circumstantial evidence of intent is permissible. See Haeske v. Arlington (In re Arlington), 192 B.R. 494, 498 (Bankr. N.D. Ill. 1996) (Squires, J.). The trustee's allegations of fraud are sufficient to satisfy the requirements of Rule 9(b).

ANB's final argument, that the debtor lacked the actual intent to defraud, also lacks merit. The trustee has alleged actual intent to defraud. ANB asserts that the facts alleged show that no such intent could have existed for various reasons and that the "only plausible inference" from the loan documents is that there was no intent by the debtor to defraud creditors. However, the trustee has made sufficient allegations of ANB's actual intent to withstand a motion to dismiss.

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[1]The court also notes that in Boston Trading Group, Inc., 835 F.2d 1504, 1510 (1st Cir. 1988), relied on by ANB, the court discussed a type of fraudulent conveyance in which the party to whom the conveyance was made knew of but did not participate in the fraud. Here, the trustee has alleged that ANB not only knew of the alleged fraud but participated in and induced the fraud.

Count IV - Inducement of Breach of Fiduciary Duty

The trustee alleges in Count IV that ANB induced James Monti, the debtor's former president and majority shareholder, to breach his fiduciary duty to the debtor. The trustee asserts that ANB affirmatively induced and perpetuated Monti's breach of fiduciary duty by prompting Monti to secure alternative financing despite its knowledge of his wrongdoing, by modifying its loan agreement with the debtor and by failing to declare a default on the loan and enforcing its rights under the loan agreement in an effort to preserve the debtor's appearance as a credit-worthy business.

ANB argues that the cause of action fails because: (1) the trustee lacks standing to raise the claim; (2) there was no underlying breach of fiduciary duty by Monti; and (3) the trustee has failed to allege a knowing inducement by ANB. First, ANB argues that in order to have standing, the trustee must establish not only misconduct by Monti but that the misconduct caused injury to the debtor. ANB seems to acknowledge that the trustee is a proper party to bring a claim for breach of fiduciary duty on behalf of the corporation and the unsecured creditors. See Koch Ref. v. Farmers Union Cent. Exch., Inc., 831 F.2d 1339, 1343-44 (7th Cir. 1987). However, it asserts that the trustee cannot satisfy the second standing requirement that the party suing has suffered an injury from the alleged wrongdoing. E.g., id. at 1342.

ANB relies on Colotone Liquidating Trust v. Bankers Trust N.Y. Corp., 243 B.R. 620 (S.D.N.Y. 2000), to argue that the debtor cannot possibly have been injured by the alleged conduct. In Colotone, a liquidating trustee appointed under the debtor's confirmed plan alleged that the controlling shareholder of the debtor failed to disclose the debtor's insolvency and published information suggesting that the debtor was healthy and supported by that shareholder, a large bank.

The trustee alleged that, as a result, many trade suppliers continued to do business with the debtor after it was insolvent. The court concluded that there was no injury to the debtor, the only party whose rights the liquidating trustee could enforce, because the alleged failure to disclose actually benefitted the company. ANB argues that, like the debtor in Colotone, the debtor in this case benefitted from the breach of fiduciary duty because the new lending from Cole Taylor increased rather than diminished the debtor's assets.

First, the court notes that the Colotone case involved a liquidating trustee who had only the rights of the debtor itself, not the rights of a chapter 7 trustee to prosecute general claims of unsecured creditors under § 544 of the Bankruptcy Code. Here, the trustee has both sets of rights. Therefore, the trustee can proceed if he alleges either an injury to the debtor or a "general" injury to the unsecured creditors. Koch Ref., 832 F.2d at 1343-44. The trustee has alleged an injury to both the debtor and to the unsecured creditors. These allegations are sufficient for purposes of a motion to dismiss.

In addition, unlike Colotone, the trustee in this case asserts that the debtor and the unsecured creditors were injured because the new loan permitted Monti to steal additional funds from the corporation and increased the amount of unsecured debt. The court may dismiss a claim only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the trustee's allegations. The court cannot conclude at this stage in the proceedings that there is no cognizable injury suffered by the debtor or the unsecured creditors from the increased debt.

ANB's second argument for dismissal of Count IV is that the trustee cannot show an injury caused by the underlying breach of fiduciary duty. ANB recognizes that, because of the debtor's alleged insolvency at the time of Monti's misrepresentations to Cole Taylor, Monti owed a fiduciary duty to the debtor's creditors that required Monti to preserve and protect the assets of the corporation. See In re Reuscher, 169 B.R. 498, 402 (S.D. Ill. 1994). ANB essentially makes the same argument here that it made regarding the injury requirement for standing to sue. For the reasons discussed above with respect to standing, the court concludes that the trustee has sufficiently alleged an injury from the underlying breach of fiduciary duty to withstand a motion to dismiss.

ANB's third argument, that the trustee has failed to allege sufficient facts to support an inducement claim, also fails. ANB makes various arguments for a benign interpretation of its conduct and asserts that its actions were "typical and not unusual" in the banking industry. The court should not determine what is "typical" or justified in the banking industry on a motion to dismiss. Viewing the allegations in the complaint in the light most favorable to the trustee, the court concludes that the trustee has alleged sufficient facts to support his claim.

Count V - Unjust Enrichment

In Count V, the trustee alleges that, in light of ANB's bad faith dealings with the Debtor, ANB would be unjustly enriched if it were allowed to retain the money it received when the loan was paid off. In order to establish a claim for unjust enrichment, the trustee must show that the defendant unjustly retained a benefit to the plaintiff's detriment, and that the defendant's retention of that benefit "violates fundamental principles of justice, equity, and good conscience." In re Athey Prods. Corp., 89 F.3d 430, 436 (7th Cir. 1996); see also Scholes v. Ames, 850 F. Supp 707, 711 (N.D. Ill. 1994) (citing HPI Health Care Servs., Inc. v. Mt. Vernon Hosp., Inc., 131 Ill. 2d 145, 137 Ill. Dec. 19, 545 N.E.2d 672 (1989)). ANB makes essentially the same arguments for dismissing this claim that it made regarding the inducement of breach of fiduciary claim in Count IV. For the reasons stated above with respect to Count IV, ANB's motion to dismiss Count V is denied.

Count VI - Equitable Subordination

The trustee argues for the equitable subordination of any proof of claim ANB may submit against the debtor on the basis of judicial economy. See 11 U.S.C. § 510(c). Should the trustee succeed on his fraudulent conveyance claim, the subordination count would become moot. However, the factual basis for this claim is closely entwined with the factual bases of Counts I-V. Therefore, "[i]n the interest of prudence and judicial economy," the court will consider the issue in conjunction with the trustee's other claims. Buncher Co. v. Official Comm. of Unsecured Creditors of Genfarm Ltd. P'ship IV, 229 F.3d 245, 253 (3rd Cir. 2000). The motion to dismiss Count VI is denied.

ENTERED:

December 13, 2001

CAROL A. DOYLE
United States Bankruptcy Judge